

# Electronic Tax Return Filing, Enterprise Data Structures and Tax Compliance Risk Assessment

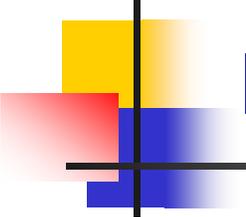
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IRS Research Conference  
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# Introduction

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- Electronic Filing Changes LMSB Risk Assessment
  - Allows Risk Assessment of Business Enterprise
  - As Opposed to Tax Return Filing Entity
- Enterprise Data Structures In Real Time
  - Using Open-Source XML and Object-Oriented Technologies
  - Programmatic Access to All Data and Structure of Data
    - Tax Returns, Financial Statements and Related Entities
- Opportunities
  - Tax Shelter Detection
  - Book-Tax Analysis
  - Simulation Modeling



## LMSB Objective

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- Allocate LMSB Audit Resources to Maximize Long-Run Voluntary Compliance
  - Estimate Issue-Specific Compliance Risk for Each Taxpayer
  - Transform Risk Measures into Resource Allocation Policy
- Data Corollary
  - Collect and Store All Relevant Data on Business Enterprise to Fully Understand Compliance Risk
    - Data May Be Multi-Dimensional in Nature
    - Structure of Data May Vary Over Units of Observation
  - Transform Data into Vector of Rankings Reflecting Resource Allocation Policy

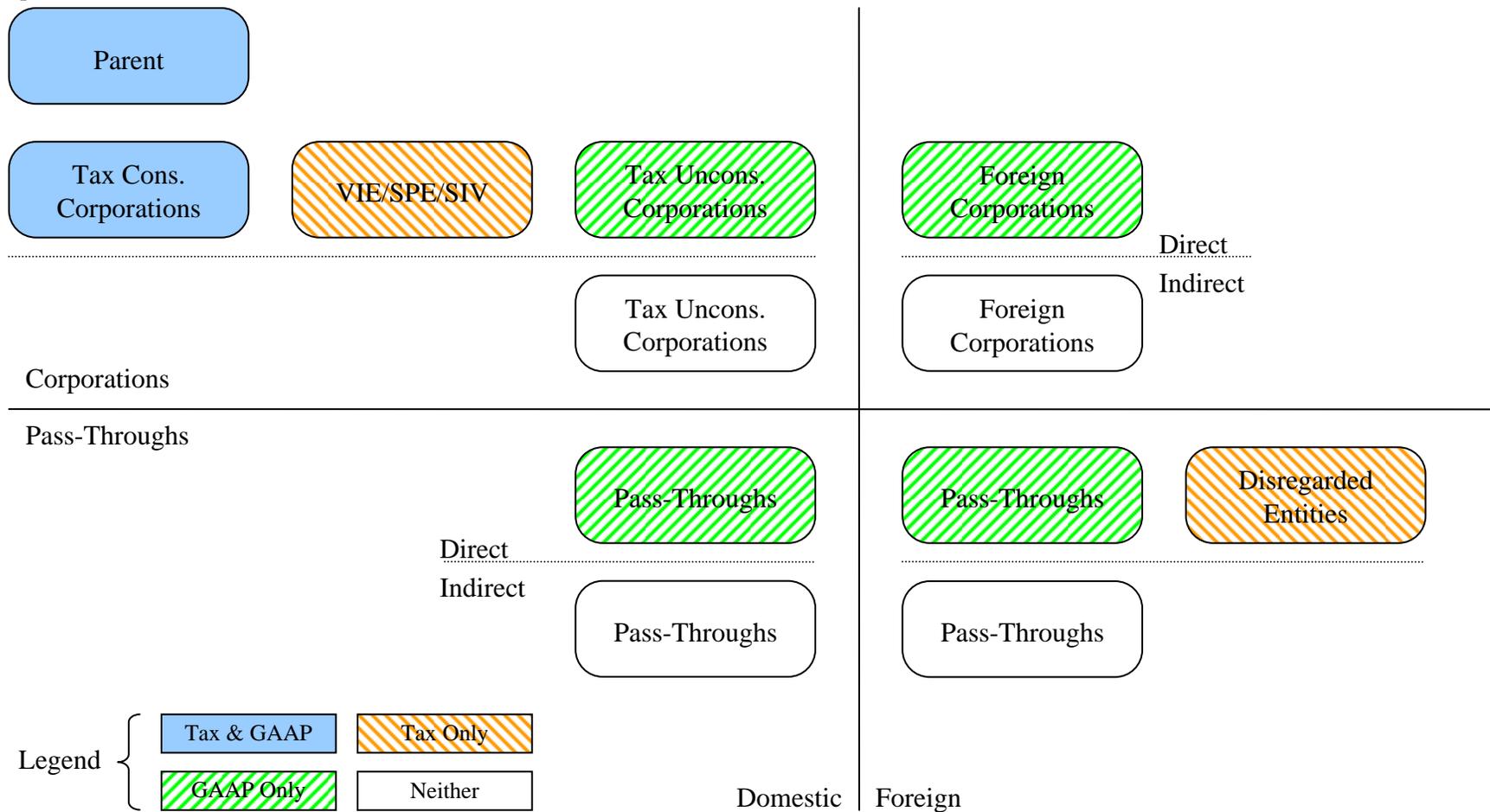


## Complex Business Enterprises

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- LMSB Needs to Assess Compliance Risk in Context of the Broad Business Enterprise, Not Tax-Filing Entity
- Enterprise is Collection of Related Entities
  - Under Common Control
  - Acting for Benefit of Owners of Enterprise
- Proliferation of Partnerships Among LMSB Population
  - LLCs as Substitutes for Corporate Subsidiaries
  - Tiered Flow-Through Structures
- Ability of LMSB to Identify Aggressive Transactions Depends on Ability to See All Sides of Transaction
- Neither Consolidated Tax Returns Nor GAAP Financial Statements Report Whole Story

# Enterprise Structure: Tax vs. GAAP Consolidation





# Electronic Filing

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- LMSB Corporations Required to File Returns in XML Format for Tax Years Ending on or After 12-31-05
- XML (eXtensible Markup Language)
  - Character-Based and Platform-Independent
  - Excels at Representing Hierarchically-Structured Data
    - Using Nested Tags
  - Can Represent Complex Business Enterprises
- Availability of Open-Source XML Technologies
  - To Convert, Combine and Restructure XML Data
- XML is Foundation for Analyzing Complex Business Enterprises and Their Features



# Object-Oriented Technology

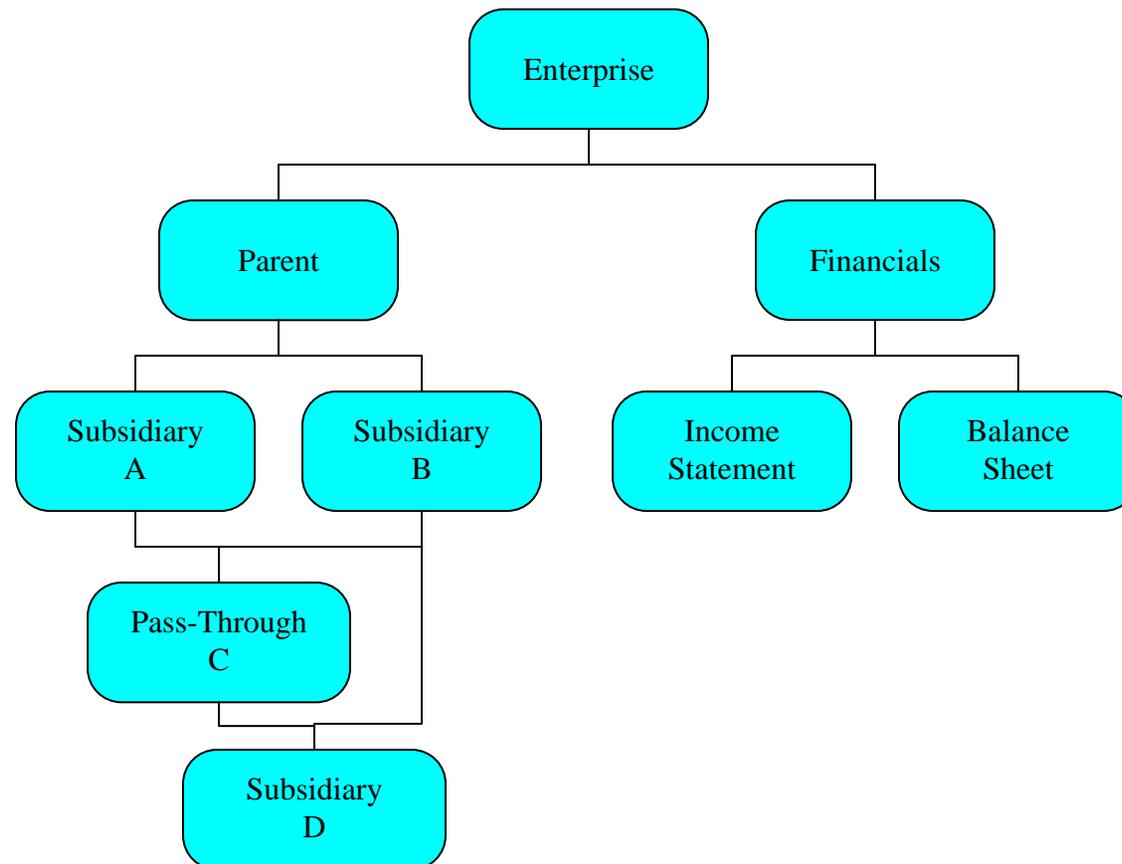
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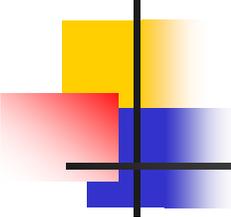
- Object-Oriented Technology Can Transform XML Enterprise Documents into Analytic Form
  - XML is Character-Based and Not Conducive to Analysis
- Can Create Enterprise Object Models
  - Comprised of Objects Representing Structural Components of Enterprise (e.g., Parents, Subsidiaries, Flow-Throughs)
  - Ownership Objects Keep Track of Entity Relationships
  - Risk Assessment Objects Compute Risk Measures Over Varied Enterprise Structures
- Can Access All Data and Structure of the Data



# Stylized Enterprise Structure

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# AICS Application

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- Automated International Classification System (AICS) Team Has Developed Application
  - Reads Return and Creates Enterprise Object in Real Time
  - Form 1120, 926, 1118, 5471, 5472, 8858 and 8865 Objects
  - Does Not Yet Include Financial Data or Related Entity Data
- Risk Assessment Objects for International Issues and Schedule M-3
- Results Represented in XML Compatible Format
  - Transformed into PDF Reports
  - Possible to Represent Results in XHTML Format
- Supports Several Compliance Initiative Projects

- [-] LMSB
  - [-] Enterprise
    - [-] Return
    - [-] RelatedReturns
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        - [-] ein
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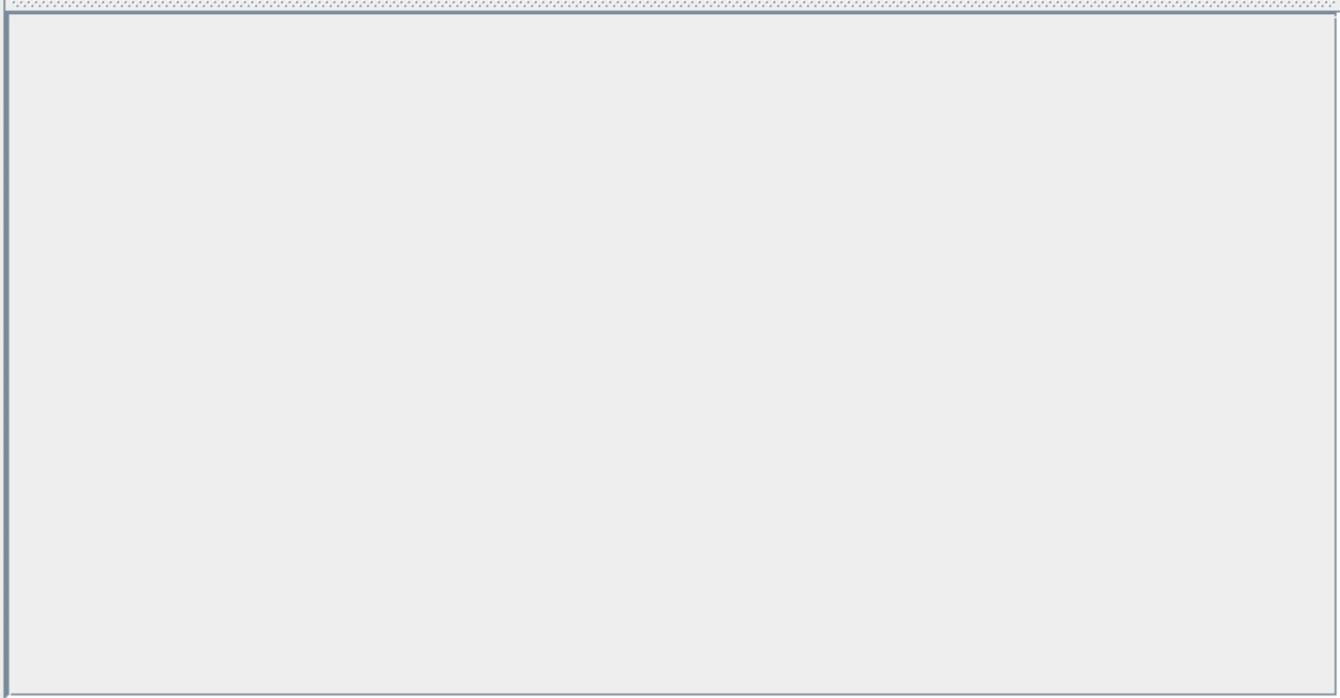
Maple Finance Incorporated  
 1213 Wilson Drive  
 Washington, DC 20599  
 2005-12-31

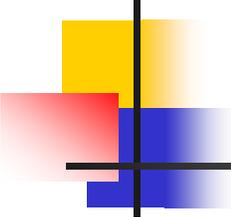
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|-----------|---|
| Sample    | ▼ |
| 000000000 | ▼ |

**FilterName**

**Filter Description**

|                   |                  |                  |                      |                             |
|-------------------|------------------|------------------|----------------------|-----------------------------|
| <b>Total Risk</b> | <b>Certainty</b> | <b>Threshold</b> | <b>NOL Carryover</b> | <b>Excess Foreign Taxes</b> |
|                   |                  |                  | \$0                  | \$0                         |

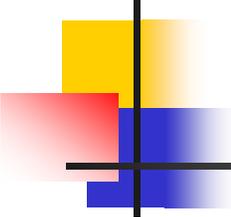




## AICS Application: Next Steps

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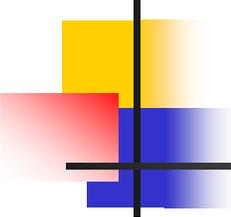
- Incorporate Financial Statement and Related Entity Data into XML and Enterprise Objects
  - Identification of Related Entities from Schedule K-1 (and Other Sources)
    - Forms 1120 and 1065 to Require Ownership Information for Tax Years Ending On or After 12-31-08
  - Recursive Process Needed to Incorporate Chains of Related Entities
  - Set Ownership/Control Parameters and Stopping Rules
  - Resolve Complex Entity Relationships



# Opportunities

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- Tax Shelter Detection
  - Search for Conditions (e.g., Structural) Across Population
  - Analytic Version of YK1 Tool
- Book-Tax Analysis
  - Risk Assessment of Book-Tax Consolidation Differences
- Simulation Modeling
  - Simulate Changes in Features (e.g., Structure) of Profit-Maximizing Enterprise as Basis for Risk Assessment
  - Distinguish Economic- from Tax-Motivated Behavior
  - Alternative to Statistical Risk Assessment Models



## Conclusion

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- Electronic Filing Should Increase Accuracy of LMSB's Compliance Risk Models
  - Access to Data on the Broad Business Enterprise
    - Including Structural Relationships Among the Component Entities
  - Ability to Perform Compliance Risk Assessment When Return is Filed
- Should Also Lead to More Efficient Workload Allocation Process
  - Better Targeted and More Informed Examinations
  - Reduced Burden on More Compliant Taxpayers